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In the
Supreme Court of the United States

OCTOBER TERM, 1964

No. 511

MIDDLESEX COUNTY NATIONAL BANK,
PETITIONER,

v.

EDWARD D. HASSAN, TRUSTEE,
RESPONDENT.

[In the Matter of
MYSTIC PIPE & SUPPLY CORP.,
Bankrupt.]

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT

Petitioner prays that a Writ of Certiorari issue to review the judgment of the United States Court of Appeals for the First Circuit in the above-entitled case, entered July 6, 1964.

Citations to Opinions Below

There was no opinion in the United States District Court for the District of Massachusetts. The opinion of the

Court of Appeals for the First Circuit is, as yet, unreported and is printed in Appendix A and pages 31-35 of the record.

Judgments Below

The judgment of the United States District Court for the District of Massachusetts was entered on January 31, 1964 (R. 25):

The judgment of the Court of Appeals for the First Circuit is annexed hereto as Appendix B.

Jurisdiction

The judgment of the Court of Appeals was entered on July 6, 1964, (R. 36).

Rehearing was denied on July 22, 1964 (R. 40).

The jurisdiction of this Court is invoked pursuant to the provisions of 28 U.S.C. 1254(1).

Questions Presented

1. Whether preliminary findings of fact must be made by the court prior to the allowance, in its discretion, of the introduction of any evidence under the doctrine of retrojection?

2. What foundation must be established by the Trustee in Bankruptcy before the Court, in its discretion, allows the introduction of further evidence under the doctrine of retrojection?

3. Are the well established rules concerning the admissibility of evidence disregarded when the Trustee in Bankruptcy invokes the doctrine of retrojection?

Statutes Involved

The statutes involved in this case are Sections 60(a) and (b) of the Bankruptcy Act, 11 U.S.C. Section 96(a) and

(b); Section 1 (19) of the Bankruptcy Act, 11 U.S.C. Section 1(15); Rule 43(a), Federal Rules of Civil Procedure, Title 28, U.S.C.

The pertinent text of these statutes are annexed hereto as Appendix C.

Statement

The bankrupt, Mystic Pipe & Supply Corp. prior to its adjudication in bankruptcy on January 23, 1962, was engaged in the business of selling plumbing and plumbing supplies (R. 2-3). During the course and conduct of its business, the bankrupt, had assigned to your petitioner certain of its accounts receivables as security for loans which your petitioner made to the bankrupt (R. 5, 8). Subsequent to its adjudication in bankruptcy, the respondent was duly appointed as Trustee in Bankruptcy on February 28, 1962 (R. 2). Thereafter the respondent commenced proceedings in the District Court against your petitioner under Sections 60(a) and (b) of the Bankruptcy Act, 11 U.S.C. Sections 96(a) and (b) to set aside certain transfers, as voidable preferences made by the bankrupt to your petitioner within four months of the filing of the petition (R. 2-3).

At the trial before the Court sitting without a jury, the respondent called as a witness a certified public accountant, in order to show that the bankrupt was insolvent on the dates of the transfers. The witness testified that according to his accounting tabulations, the bankrupt was insolvent. However, the accountant stated upon further inquiry that the figure representing the inventory in his accounting tabulations was estimated (R. 11) and hence his tabulations and conclusions therefrom as to insolvency would not be supported by the figures as set forth in the general ledger (R. 11-12). The Court then struck from the record the

testimony of the accountant with respect to the insolvency of the bankrupt at the time of the alleged voidable preferences (R. 12). The respondent's only other witness was the former president and treasurer of the bankrupt. This witness testified that he did not know if the books before him was the general ledger of the bankrupt (R. 28-29). He was not familiar with the books (R. 29). The respondent then sought to establish the value of the inventory on the date the petition was filed though the testimony of this witness, who had participated in the taking of the inventory. The District Court excluded it, on the basis that the testimony standing alone was meaningless and remote in ascertaining the insolvency of the bankrupt at the critical dates (R. 12-16).

The District Court at the conclusion of the hearing, entertained and granted the petitioner's motion for judgment on the basis that there has been no showing of insolvency (R. 18).

The Court of Appeals decided and determined that under the doctrine of retrojection, that the excluded testimony was admissible. The judgment of the District Court was vacated and remanded the case for a new trial (R. 31-36).

Reasons for Granting the Writ

The decision of the Court of Appeals disregarded the basic concept of the doctrine of retrojection in its application to this case.

The Court acknowledged that the Trustee in Bankruptcy under the doctrine of retrojection must be able to show the absence of any substantial or radical changes in the assets or liabilities of the bankrupt between the retrojection dates. *McClung-Logan Equipment Co.* v. *Friedman*, 195 F2d 16 (4th Cir. 1952). However, the Court in almost the same breath states that the excluded testimony of both the ac-

countant and the corporate officer, who was president and treasurer, is competent testimony under the doctrine of retrojection toward establishing insolvency on the critical date in issue, even though no evidence had been offered as to the absence of any substantial or radical changes in the assets or liabilities of the bankrupt between retrojection dates. The Court is silent on that point.

The Court discusses the case of *Rosenberg* v. *Semple*, 257 Fed. 72 (3rd Cir. 1919) and cites that case as its authority for this decision. Clearly that case has no application to this matter. In the Rosenberg case, the Referee in Bankruptcy made a finding of fact that the inventory and machinery was substantially the same in quantity and value between the date of bankruptcy and the prior critical dates. Furthermore, that the Bankrupt conducted very little business, subsequent to the alleged voidable preferences. On the basis of the factual situation before him the Referee in Bankruptcy allowed the accountant to retroject the financial condition of the bankrupt in order to show insolvency on the preferential dates. The decision of the Court below is in conflict with *Rosenberg* v. *Semple*, *supra*, and presents a problem of critical importance in the administration of the Bankruptcy Act and which should be finally settled by this Court.

It is stated in Collier on Bankruptcy (14th ed.) Section 1.19 at page 96-97:

> ***No presumption arises from an adjudication in bankruptcy that the debtor was insolvent for any period before the petition in bankruptcy was filed, nor is it permissible to "retroject" the insolvency of the bankrupt found to exist at the time of the adjudication or petition to a date prior thereto, except only within the narrow limits, depending on time and circumstances, where it is possible to draw a legitimate

inference to that effect. Consequently, the controlling valuations of the assets have to be made as of the critical time.***

Mutual Savings & Loan Association v. *McCants*, 183 F2d 423 (4th Cir., 1950); *Everett* v. *Warfield Mining Co.*, 37 F2d 328 (4th Cir., 1930); *Dinkelspiel* v. *Weaver*, (D. C. of Ark. 1953), 116 F. Supp. 455; *Allender* v. *Southeast Tractor & Equipment Company*, (D. C. of Tenn. 1959), 178 F. Supp. 413.

Nowhere in any of the decisions of the Courts construing the doctrine of retrojection has there been any well defined rule as to the admissibility of evidence offered and invoked under this doctrine. The Court below is of the opinion that any evidence was admissible even though it was irrelevant or hearsay. This decision in fact has created an exception to the hearsay rule. Needless to say, if this decision is permitted to stand, it will cloud the already dark area of the doctrine of retrojection, and furthermore and more important is that the well established rules concerning the admissibility of evidence shall be seriously breached.

Conclusion

For the foregoing reasons, this petition for a Writ of Certiorari should be granted.

Respectfully submitted,

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Appendix A

United States Court of Appeals
For the First Circuit

No. 6313.

EDWARD D. HASSAN, TRUSTEE,
PLAINTIFF, APPELLANT,
v.
MIDDLESEX COUNTY NATIONAL BANK,
DEFENDANT, APPELLEE.

[In the Matter of
MYSTIC PIPE & SUPPLY CORP.,
Bankrupt.]

APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MASSACHUSETTS

Before WOODBURY, *Chief Judge*, and HARTIGAN and ALDRICH, *Circuit Judges*.

Michael H. Goshko, with whom *John F. McCarty, Jr.*, and *Cohn, Riemer & Pollack* were on brief, for appellant.
Cyril Hochberg, with whom *Arthur T. Wasserman* and *Wasserman & Slater* were on brief, for appellee.

OPINION OF THE COURT.

July 6, 1964.

HARTIGAN, *Circuit Judge*. Plaintiff-appellant, Edward D. Hassan, Trustee in Bankruptcy of Mystic Pipe & Supply Corp., brought suit in the United States District Court for the District of Massachusetts under Sections 60(a) and (b) of the Bankruptcy Act to set aside as voidable preferences three transfers alleged to have been made by the

bankrupt to defendant-appellee, Middlesex County National Bank, within four months of the filing of the petition. The district Court ruled that there had been no showing of insolvency and no proof to support the allegation of the complaint that Mystic was insolvent when the questioned transfers took place. Judgment was entered for appellee on January 31, 1964, and appellant appeals.

The facts are these. On January 23, 1962, Mystic Pipe & Supply Corp., a Massachusetts corporation engaged in the business of selling plumbing supplies, filed a petition in bankruptcy pursuant to Section 322 of the Act. Appellant was appointed trustee and subsequently brought this action against Middlesex. Two of the transfers sought to be set aside were alleged to have taken place on October 23 and 25, 1961 and were of accounts receivable which Mystic had assigned to appellee as security for loans made to it by appellee. The third transfer was allegedly made on November 10, 1961 and concerned a payment to Middlesex of $10,000.

At the trial before the court sitting without a jury, the trustee sought to show that Mystic was insolvent on the dates of the transfers. To this end, a certified public accountant testified that he had prepared a balance sheet which showed that on September 30, 1961 the bankrupt had a net deficit of $84,252.54. The figures and computations used to reach that result were obtained from the general ledger of Mystic with the exception of the figure used for inventory. That figure was arrived at by the accountant's taking the results of a closing physical inventory, taken as of January 23, 1962 by Mystic's president and treasurer, Marino Matrundola, and, working backward through the entries in the general ledger, adjusting the January 23 figure to reflect sales, purchases and returns made since September 30, 1961. By similarly working backward through the general ledger, and with Mystic's financial con-

dition as of September 30 established, appellant intended to demonstrate the bankrupt's insolvency on each of the transfer dates.

To lay the foundation necessary for placing the general ledger in evidence as a basis for the accountant's testimony, appellant called Matrundola to the stand. He stated that he was unfamiliar with the corporation's books. Appellant seemed surprised at this result and the court allowed the accountant to testify anyway with the proviso that if the ledger was not subsequently admitted in evidence, the testimony would have no foundation. Appellant, however, was given no further opportunity to lay the proper foundation for the ledger through another witness. Upon learning that the result reached on the balance sheet was not derived solely from the general ledger, the court struck the accountant's testimony and the three exhibits offered in conjunction therewith as hearsay.[1] Since the only other source relied on by the account was the physical inventory taken by Matrundola, he was recalled to the stand to testify concerning that procedure. The court then stated its belief that even if appellant succeeded in establishing Mystic's financial condition as of September 30, 1961 and then, working backward from the January, 1962 inventory, showed Mystic's insolvency on the transfer dates, it would not be persuaded by such testimony due to the possible existence of thieves, embezzlers, careless deliveries, etc., which would make the situation as it was in January, 1962 "not very persuasive as to what the situation was" on earlier dates. It felt, therefore, that testimony as to the value of inventory as of the January date was of no significance and sustained appellee's objection to such testimony, thus cutting short appellant's attempt to prove insolvency through retrojection, the only way it could be proved under the circum-

[1] The exhibits included the above mentioned balance sheet and a trial balance and profit and loss statement.

stances. On the basis of appellee's failure to prove insolvency on the critical dates, judgment was entered for appellee.

We believe the lower court erred in ruling that the trustee could not prove insolvency on the preferential dates in the only manner available to him. Appellant was forced to resort to this round-about method due to the fact that no inventory of the corporation taken since June of 1960 had been certified by an accountant or made available to him. Insolvency is not always susceptible of direct proof and frequently must be determined by the proof of other facts or factors from which the ultimate fact of insolvency on the transfer dates must be inferred or presumed. 1 Collier on Bankruptcy 123 (14th ed. 1962). The method sought to be used by appellant is not novel and has been utilized often in bankruptcy proceedings. See, *e.g.*, *Inter-State National Bank of Kansas City* v. *Luther*, 221 F.2d 382, 391 (10th Cir. 1955); *Mutual Savings & Loan Association* v. *McCants*, 183 F.2d 423, 425 (4th Cir. 1950); *Rosenberg* v. *Semple*, 257 Fed. 72 (3rd Cir. 1919); *In re Great Western Biscuit Co.*, 85 F. Supp. 314 (S.D. Cal. 1949). In *Rosenberg* v. *Semple*, *supra*, a balance sheet dated December 1 showing the bankrupt to be running a deficit shortly before the preferred transfer was competent to help establish insolvency on the transfer date where, as here, the statement was made up from books of the company with the exception of the inventory item which was taken from the inventory and appraisement filed in the bankruptcy proceedings and worked back to the December 1 date. When such a method is sought to be invoked it is essential that the trustee be able to show the absence of any substantial or radical changes in the assets or liabilities of the bankrupt between the retrojection dates. *McClung-Logan Equipment Co.* v. *Friedman*, 195 F.2d 516 (4th Cir. 1952). This appellant was prepared to do through the general ledger. Appellee

argues that the failure of the trustee to get the ledger admitted into evidence was fatal to his case. But even if appellant had been given another opportunity to gain its admission, which he was not, the trial court's view as to the January 23 inventory would have made the ledger meaningless.

Assuming the eventual foundation being laid for the general ledger, the testimony of the accountant and of Matrundola was competent testimony toward establishing insolvency on the three dates in issue. See *Abdo* v. *Townshend*, 282 Fed. 476, 480 (4th Cir. 1922); see also *Badders Clothing Co.* v. *Burnham-Munger-Root D. G. Co.*, 228 Fed. 470, 474 (8th Cir. 1915). The probative force of such testimony was, of course, for the court to determine, but appellant should have been allowed to introduce all his evidence in an effort to establish his case and allow the court to draw the proper inferences. An *a priori* finding by the court that, if admitted, it would not believe a particular piece of testimony is not a proper basis for an exclusionary ruling. The probative force of testimony is to be determined when all offered admissible evidence has been introduced and counsel has had an opportunity to argue his case. The error was particularly marked here because the issue was not the credibility of the proffered testimony, but was whether the conclusion that would normally follow therefrom should not be drawn because of some additional circumstances—"thieves, embezzlers," etc. As to this the burden would not have been on the proponent of the evidence; but on the opponent. The court's personal feeling, amounting, in effect, to a conclusive presumption of wrongdoing was, at best, premature.

Judgment will be entered vacating the judgment of the district court, and remanding the case for a new trial consistent with this opinion.

Appendix B

UNITED STATES COURT OF APPEALS
FOR THE FIRST CIRCUIT

No. 6313.

EDWARD D. HASSAN, TRUSTEE,
PLAINTIFF, APPELLANT,

v.

MIDDLESEX COUNTY NATIONAL BANK,
DEFENDANT, APPELLEE.

[In the Matter of
MYSTIC PIPE & SUPPLY CORP.,
Bankrupt.]

JUDGMENT
July 6, 1964

This cause came on to be heard on appeal from the United States District Court for the District of Massachusetts, and was argued by counsel.

Upon consideration whereof, It is now here ordered, adjudged and decreed as follows: The judgment of the District Court is vacated, and the case is remanded to that Court for further proceedings consistent with the opinion filed this day.

By the Court:
(s) ROGER A. STINCHFIELD,
Clerk.

[cc: Messrs. Goshko and Hochberg.]

Appendix C

Section 60(a) of the Bankruptcy Act, 11 U.S.C. Section 96(a)

"A preference is a transfer, as defined in this title, of any of the property of a debtor to or for the benefit of a creditor for or on account of an antecedent debt, made or suffered by such debtor while insolvent and within four months before the filing by or against him of the petition in bankruptcy, or of the original petition under chapter 10, 11, 12, or 13 of this title, the effect of which transfer will be to enable such creditor to obtain a greater percentage of his debt than some other creditor of the same class. For the purposes of subdivisions a and b of this section, a transfer shall be deemed to have been made at the time when it became so far perfected that no bona-fide purchaser from the debtor and no creditor could thereafter have acquired any rights in the property so transferred superior to the rights of the transferee therein, and, if such transfer is not so perfected prior to the filing of the petition in bankruptcy or of the original petition under chapter 10, 11, 12 or 13 of this title, it shall be deemed to have been made immediately before bankruptcy."

Section 60(b) of the Bankruptcy Act, 11 U.S.C. Section 96(b)

"Any such preference may be avoided by the trustee if the creditor receiving it or to be benefited thereby or his agent acting with reference thereto has, at the time when the transfer is made, reasonable cause to believe that the debtor is insolvent. Where the preference is voidable, the trustee may recover the property or, if it has been converted, its value from any person who has received or converted such property, except a bona-fide purchaser from or lienor of the debtor's transferee for a present fair equivalent value: Provided, however, that where such pur-

chaser or lienor has given less than such value, he shall nevertheless have a lien upon such property, but only to the extent of the consideration actually given by him. Where a preference by way of lien or security title is voidable, the Court may on due notice order such lien or title to be preserved for the benefit of the estate, in which event such lien or title shall pass to the trustee. For the purpose of any recovery or avoidance under this section, where plenary proceedings are necessary, any State court which would have had jurisdiction if bankruptcy had not intervened and any court of bankruptcy shall have concurrent jurisdiction. Section 1(19) of the Bankruptcy Act 11 U.S.C. Section (11.15).

"A person shall be deemed insolvent within the provisions of this Act whenever the aggregate of his property, exclusive of any property which he may have conveyed, transferred, concealed, removed, or permitted to be concealed or removed, with intent to defraud, hinder, or delay his creditors, shall not at a fair valuation be sufficient in amount to pay his debts;"

Rule 43 (A) of the Federal Rules of Civil Procedure, Title 28. U.S.C.A.

"In all trials the testimony of witnesses shall be taken orally in open court, unless otherwise provided by these rules. All evidence shall be admitted which is admissible under the statutes of the United States, or under the rules of evidence heretofore applied in the courts of the United States on the hearing of suits in equity, or under the rules of evidence applied in the courts of general jurisdiction of the state in which the United States court is held. In any case, the statute or rule which favors the reception of the evidence governs and the evidence shall be presented according to the most convenient method prescribed in any of the statutes or rules to which reference is herein made. The competency of a witness to testify shall be determined in like manner."